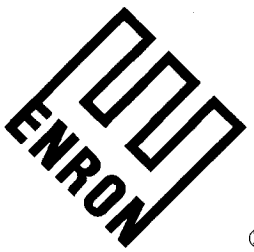

William Powers, Jr.
Member of the Enron Board of Directors and
Chairman of the Special Investigation Committee

3600 Murillo Circle
Austin, TX 78703
512-232-1120

February 1, 2002

To the Members of the Board of Directors
Enron Corporation

Enclosed is a copy of the Report of the Special Investigation Committee.

Sincerely,

William Powers, Jr.

Enclosure

REPORT OF INVESTIGATION

BY THE

SPECIAL INVESTIGATIVE COMMITTEE
OF THE
BOARD OF DIRECTORS OF ENRON CORP.

William C. Powers, Jr., Chair
Raymond S. Troubh
Herbert S. Winokur, Jr.

Counsel
Wilmer, Cutler & Pickering

February 1, 2002

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EXECUTIVE SUMMARY AND CONCLUSIONS

The Special Investigative Committee of the Board of Directors of Enron Corp. submits this Report of Investigation to the Board of Directors. In accordance with our mandate, the Report addresses transactions between Enron and investment partnerships created and managed by Andrew S. Fastow, Enron's former Executive Vice President and Chief Financial Officer, and by other Enron employees who worked with Fastow.

The Committee has done its best, given the available time and resources, to conduct a careful and impartial investigation. We have prepared a Report that explains the substance of the most significant transactions and highlights their most important accounting, corporate governance, management oversight, and public disclosure issues. An exhaustive investigation of these related-party transactions would require time and resources beyond those available to the Committee. We were not asked, and we have not attempted, to investigate the causes of Enron's bankruptcy or the numerous business judgments and external factors that contributed it. Many questions currently part of public discussion—such as questions relating to Enron's international business and commercial electricity ventures, broadband communications activities, transactions in Enron securities by insiders, or management of employee 401(k) plans—are beyond the scope of the authority we were given by the Board.

There were some practical limitations on the information available to the Committee in preparing this Report. We had no power to compel third parties to submit to interviews, produce documents, or otherwise provide information. Certain former Enron employees who (we were told) played substantial roles in one or more of the

transactions under investigation—including Fastow, Michael J. Kopper, and Ben F. Glisan, Jr.—declined to be interviewed either entirely or with respect to most issues. We have had only limited access to certain workpapers of Arthur Andersen LLP ("Andersen"), Enron's outside auditors, and no access to materials in the possession of the Fastow partnerships or their limited partners. Information from these sources could affect our conclusions.

This Executive Summary and Conclusions highlights important parts of the Report and summarizes our conclusions. It is based on the complete set of facts, explanations and limitations described in the Report, and should be read with the Report itself. Standing alone, it does not, and cannot, provide a full understanding of the facts and analysis underlying our conclusions.

Background

On October 16, 2001, Enron announced that it was taking a $544 million after-tax charge against earnings related to transactions with LJM2 Co-Investment, L.P. ("LJM2"), a partnership created and managed by Fastow. It also announced a reduction of shareholders' equity of $1.2 billion related to transactions with that same entity.

Less than one month later, Enron announced that it was restating its financial statements for the period from 1997 through 2001 because of accounting errors relating to transactions with a different Fastow partnership, LJM Cayman, L.P. ("LJM1"), and an additional related-party entity, Chewco Investments, L.P. ("Chewco"). Chewco was managed by an Enron Global Finance employee, Kopper, who reported to Fastow.

The LJM1- and Chewco-related restatement, like the earlier charge against earnings and reduction of shareholders' equity, was very large. It reduced Enron's reported net income by $28 million in 1997 (of $105 million total), by $133 million in 1998 (of $703 million total), by $248 million in 1999 (of $893 million total), and by $99 million in 2000 (of $979 million total). The restatement reduced reported shareholders' equity by $258 million in 1997, by $391 million in 1998, by $710 million in 1999, and by $754 million in 2000. It increased reported debt by $711 million in 1997, by $561 million in 1998, by $685 million in 1999, and by $628 million in 2000. Enron also revealed, for the first time, that it had learned that Fastow received more than $30 million from LJM1 and LJM2. These announcements destroyed market confidence and investor trust in Enron. Less than one month later, Enron filed for bankruptcy.

Summary of Findings

This Committee was established on October 28, 2001, to conduct an investigation of the related-party transactions. We have examined the specific transactions that led to the third-quarter 2001 earnings charge and the restatement. We also have attempted to examine all of the approximately two dozen other transactions between Enron and these related-party entities: what these transactions were, why they took place, what went wrong, and who was responsible.

Our investigation identified significant problems beyond those Enron has already disclosed. Enron employees involved in the partnerships were enriched, in the aggregate, by tens of millions of dollars they should never have received—Fastow by at least $30 million, Kopper by at least $10 million, two others by $1 million each, and still two more

by amounts we believe were at least in the hundreds of thousands of dollars. We have seen no evidence that any of these employees, except Fastow, obtained the permission required by Enron's Code of Conduct of Business Affairs to own interests in the partnerships. Moreover, the extent of Fastow's ownership and financial windfall was inconsistent with his representations to Enron's Board of Directors.

This personal enrichment of Enron employees, however, was merely one aspect of a deeper and more serious problem. These partnerships—Chewco, LJM1, and LJM2—were used by Enron Management to enter into transactions that it could not, or would not, do with unrelated commercial entities. Many of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve *bona fide* economic objectives or to transfer risk. Some transactions were designed so that, had they followed applicable accounting rules, Enron could have kept assets and liabilities (especially debt) off of its balance sheet; but the transactions did not follow those rules.

Other transactions were implemented—improperly, we are informed by our accounting advisors—to offset losses. They allowed Enron to conceal from the market very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged—that is, that a third party was obligated to pay Enron the amount of those losses—when in fact that third party was simply an entity in which only Enron had a substantial economic stake. We believe these transactions resulted in Enron reporting earnings from the third quarter of 2000 through the third quarter of 2001 that were almost $1 billion higher than should have been reported.

Enron's original accounting treatment of the Chewco and LJM1 transactions that led to Enron's November 2001 restatement was clearly wrong, apparently the result of mistakes either in structuring the transactions or in basic accounting. In other cases, the accounting treatment was likely wrong, notwithstanding creative efforts to circumvent accounting principles through the complex structuring of transactions that lacked fundamental economic substance. In virtually all of the transactions, Enron's accounting treatment was determined with extensive participation and structuring advice from Andersen, which Management reported to the Board. Enron's records show that Andersen billed Enron $5.7 million for advice in connection with the LJM and Chewco transactions alone, above and beyond its regular audit fees.

Many of the transactions involve an accounting structure known as a "special purpose entity" or "special purpose vehicle" (referred to as an "SPE" in this Summary and in the Report). A company that does business with an SPE may treat that SPE as if it were an independent, outside entity for accounting purposes if two conditions are met: (1) an owner independent of the company must make a substantive equity investment of at least 3% of the SPE's assets, and that 3% must remain at risk throughout the transaction; and (2) the independent owner must exercise control of the SPE. In those circumstances, the company may record gains and losses on transactions with the SPE, and the assets and liabilities of the SPE are not included in the company's balance sheet, even though the company and the SPE are closely related. It was the technical failure of some of the structures with which Enron did business to satisfy these requirements that led to Enron's restatement.

Summary of Transactions and Matters Reviewed

The following are brief summaries of the principal transactions and matters in which we have identified substantial problems:

The Chewco Transaction

The first of the related-party transactions we examined involved Chewco Investments L.P., a limited partnership managed by Kopper. Because of this transaction, Enron filed inaccurate financial statements from 1997 through 2001, and provided an unauthorized and unjustifiable financial windfall to Kopper.

From 1993 through 1996, Enron and the California Public Employees' Retirement System ("CalPERS") were partners in a $500 million joint venture investment partnership called Joint Energy Development Investment Limited Partnership ("JEDI"). Because Enron and CalPERS had joint control of the partnership, Enron did not consolidate JEDI into its consolidated financial statements. The financial statement impact of non-consolidation was significant: Enron would record its contractual share of gains and losses from JEDI on its income statement and would disclose the gain or loss separately in its financial statement footnotes, but would *not* show JEDI's debt on its balance sheet.

In November 1997, Enron wanted to redeem CalPERS' interest in JEDI so that CalPERS would invest in another, larger partnership. Enron needed to find a new partner, or else it would have to consolidate JEDI into its financial statements, which it did not want to do. Enron assisted Kopper (whom Fastow identified for the role) in

forming Chewco to purchase CalPERS' interest. Kopper was the manager and owner of Chewco's general partner. Under the SPE rules summarized above, Enron could only avoid consolidating JEDI onto Enron's financial statements if Chewco had some independent ownership with a minimum of 3% of *equity* capital at risk. Enron and Kopper, however, were unable to locate any such outside investor, and instead financed Chewco's purchase of the JEDI interest almost entirely with debt, not equity. This was done hurriedly and in apparent disregard of the accounting requirements for non-consolidation. Notwithstanding the shortfall in required equity capital, Enron did not consolidate Chewco (or JEDI) into its consolidated financial statements.

Kopper and others (including Andersen) declined to speak with us about why this transaction was structured in a way that did not comply with the non-consolidation rules. Enron, and any Enron employee acting in Enron's interest, had every incentive to ensure that Chewco complied with these rules. We do not know whether this mistake resulted from bad judgment or carelessness on the part of Enron employees or Andersen, or whether it was caused by Kopper or others putting their own interests ahead of their obligations to Enron.

The consequences, however, were enormous. When Enron and Andersen reviewed the transaction closely in 2001, they concluded that Chewco did not satisfy the SPE accounting rules and—because JEDI's non-consolidation depended on Chewco's status—neither did JEDI. In November 2001, Enron announced that it would consolidate Chewco and JEDI retroactive to 1997. As detailed in the Background section above, this retroactive consolidation resulted in a massive reduction in Enron's reported net income and a massive increase in its reported debt.

Beyond the financial statement consequences, the Chewco transaction raises substantial corporate governance and management oversight issues. Under Enron's Code of Conduct of Business Affairs, Kopper was prohibited from having a financial or managerial role in Chewco unless the Chairman and CEO determined that his participation "does not adversely affect the best interests of the Company." Notwithstanding this requirement, we have seen no evidence that his participation was ever disclosed to, or approved by, either Kenneth Lay (who was Chairman and CEO) or the Board of Directors.

While the consequences of the transaction were devastating to Enron, Kopper reaped a financial windfall from his role in Chewco. This was largely a result of arrangements that he appears to have negotiated with Fastow. From December 1997 through December 2000, Kopper received $2 million in "management" and other fees relating to Chewco. Our review failed to identify how these payments were determined, or what, if anything, Kopper did to justify the payments. More importantly, in March 2001 Enron repurchased Chewco's interest in JEDI on terms Kopper apparently negotiated with Fastow (during a time period in which Kopper had undisclosed interests with Fastow in both LJM1 and LJM2). Kopper had invested $125,000 in Chewco in 1997. The repurchase resulted in Kopper's (and a friend to whom he had transferred part of his interest) receiving more than $10 million from Enron.

The LJM Transactions

In 1999, with Board approval, Enron entered into business relationships with two partnerships in which Fastow was the manager and an investor. The transactions between

Enron and the LJM partnerships resulted in Enron increasing its reported financial results by more than a billion dollars, and enriching Fastow and his co-investors by tens of millions of dollars at Enron's expense.

The two members of the Special Investigative Committee who have reviewed the Board's decision to permit Fastow to participate in LJM notwithstanding the conflict of interest have concluded that this arrangement was fundamentally flawed.[1/] A relationship with the most senior financial officer of a public company—particularly one requiring as many controls and as much oversight by others as this one did—should not have been undertaken in the first place.

The Board approved Fastow's participation in the LJM partnerships with full knowledge and discussion of the obvious conflict of interest that would result. The Board apparently believed that the conflict, and the substantial risks associated with it, could be mitigated through certain controls (involving oversight by both the Board and Senior Management) to ensure that transactions were done on terms fair to Enron. In taking this step, the Board thought that the LJM partnerships would offer business benefits to Enron that would outweigh the potential costs. The principal reason advanced by Management in favor of the relationship, in the case of LJM1, was that it would permit Enron to accomplish a particular transaction it could not otherwise accomplish. In

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1/ One member of the Special Investigative Committee, Herbert S. Winokur, Jr., was a member of the Board of Directors and the Finance Committee during the relevant period. The portions of the Report describing and evaluating actions of the Board and its Committees are solely the views of the other two members of the Committee, Dean William C. Powers, Jr. of the University of Texas School of Law and Raymond S. Troubh.

the case of LJM2, Management advocated that it would provide Enron with an additional potential buyer of assets that Enron wanted to sell, and that Fastow's familiarity with the Company and the assets to be sold would permit Enron to move more quickly and incur fewer transaction costs.

Over time, the Board required, and Management told the Board it was implementing, an ever-increasing set of procedures and controls over the related-party transactions. These included, most importantly, review and approval of all LJM transactions by Richard Causey, the Chief Accounting Officer; and Richard Buy, the Chief Risk Officer; and, later during the period, Jeffrey Skilling, the President and COO (and later CEO). The Board also directed its Audit and Compliance Committee to conduct annual reviews of all LJM transactions.

These controls as designed were not rigorous enough, and their implementation and oversight was inadequate at both the Management and Board levels. No one in Management accepted primary responsibility for oversight; the controls were not executed properly; and there were structural defects in those controls that became apparent over time. For instance, while neither the Chief Accounting Officer, Causey, nor the Chief Risk Officer, Buy, ignored his responsibilities, they interpreted their roles very narrowly and did not give the transactions the degree of review the Board believed was occurring. Skilling appears to have been almost entirely uninvolved in the process, notwithstanding representations made to the Board that he had undertaken a significant role. No one in Management stepped forward to address the issues as they arose, or to bring the apparent problems to the Board's attention.

As we discuss further below, the Board, having determined to allow the related-party transactions to proceed, did not give sufficient scrutiny to the information that was provided to it thereafter. While there was important information that appears to have been withheld from the Board, the annual reviews of LJM transactions by the Audit and Compliance Committee (and later also the Finance Committee) appear to have involved only brief presentations by Management (with Andersen present at the Audit Committee) and did not involve any meaningful examination of the nature or terms of the transactions. Moreover, even though Board Committee-mandated procedures required a review by the Compensation Committee of Fastow's compensation from the partnerships, neither the Board nor Senior Management asked Fastow for the amount of his LJM-related compensation until October 2001, after media reports focused on Fastow's role in LJM.

From June 1999 through June 2001, Enron entered into more than 20 distinct transactions with the LJM partnerships. These were of two general types: asset sales and purported "hedging" transactions. Each of these types of transactions was flawed, although the latter ultimately caused much more harm to Enron.

Asset Sales. Enron sold assets to LJM that it wanted to remove from its books. These transactions often occurred close to the end of financial reporting periods. While there is nothing improper about such transactions if they actually transfer the risks and rewards of ownership to the other party, there are substantial questions whether any such transfer occurred in some of the sales to LJM.

Near the end of the third and fourth quarters of 1999, Enron sold interests in seven assets to LJM1 and LJM2. These transactions appeared consistent with the stated purpose of allowing Fastow to participate in the partnerships—the transactions were done quickly, and permitted Enron to remove the assets from its balance sheet and record a gain in some cases. However, events that occurred after the sales call into question the legitimacy of the sales. In particular: (1) Enron bought back five of the seven assets after the close of the financial reporting period, in some cases within a matter of months; (2) the LJM partnerships made a profit on *every* transaction, even when the asset it had purchased appears to have declined in market value; and (3) according to a presentation Fastow made to the Board's Finance Committee, those transactions generated, directly or indirectly, "earnings" to Enron of $229 million in the second half of 1999 (apparently including one hedging transaction). (The details of the transactions are discussed in Section VI of the Report.) Although we have not been able to confirm Fastow's calculation, Enron's reported earnings for that period were $570 million (pre-tax) and $549 million (after-tax).

We have identified some evidence that, in three of these transactions where Enron ultimately bought back LJM's interest, Enron had agreed in advance to protect the LJM partnerships against loss. If this was in fact the case, it was likely inappropriate to treat the transactions as sales. There also are plausible, more innocent explanations for some of the repurchases, but a sufficient basis remains for further examination. With respect to those transactions in which risk apparently did not pass from Enron, the LJM partnerships functioned as a vehicle to accommodate Enron in the management of its reported financial results.

Hedging Transactions. The first "hedging" transaction between Enron and LJM occurred in June 1999, and was approved by the Board in conjunction with its approval of Fastow's participation in LJM1. The normal idea of a hedge is to contract with a creditworthy outside party that is prepared—for a price—to take on the economic risk of an investment. If the value of the investment goes down, that outside party will bear the loss. That is not what happened here. Instead, Enron transferred its own stock to an SPE in exchange for a note. The Fastow partnership, LJM1, was to provide the outside equity necessary for the SPE to qualify for non-consolidation. Through the use of options, the SPE purported to take on the risk that the price of the stock of Rhythms NetConnections Inc. ("Rhythms"), an internet service provider, would decline. The idea was to "hedge" Enron's profitable merchant investment in Rhythms stock, allowing Enron to offset losses on Rhythms if the price of Rhythms stock declined. If the SPE were required to pay Enron on the Rhythms options, the transferred Enron stock would be the principal source of payment.

The other "hedging" transactions occurred in 2000 and 2001 and involved SPEs known as the "Raptor" vehicles. Expanding on the idea of the Rhythms transaction, these were extraordinarily complex structures. They were funded principally with Enron's own stock (or contracts for the delivery of Enron stock) that was intended to "hedge" against declines in the value of a large group of Enron's merchant investments. LJM2 provided the outside equity designed to avoid consolidation of the Raptor SPEs.

The asset sales and hedging transactions raised a variety of issues, including the following:

Accounting and Financial Reporting Issues. Although Andersen approved the transactions, in fact the "hedging" transactions did not involve substantive transfers of economic risk. The transactions may have looked superficially like economic hedges, but they actually functioned only as "accounting" hedges. They appear to have been designed to circumvent accounting rules by recording hedging gains to offset losses in the value of merchant investments on Enron's quarterly and annual income statements. The economic reality of these transactions was that Enron never escaped the risk of loss, because it had provided the bulk of the capital with which the SPEs would pay Enron.

Enron used this strategy to avoid recognizing losses for a time. In 1999, Enron recognized after-tax income of $95 million from the Rhythms transaction, which offset losses on the Rhythms investment. In the last two quarters of 2000, Enron recognized revenues of $500 million on derivative transactions with the Raptor entities, which offset losses in Enron's merchant investments, and recognized pre-tax earnings of $532 million (including net interest income). Enron's reported pre-tax earnings for the last two quarters of 2000 totaled $650 million. "Earnings" from the Raptors accounted for more than 80% of that total.

The idea of hedging Enron's investments with the value of Enron's capital stock had a serious drawback as an economic matter. If the value of the investments fell at the same time as the value of Enron stock fell, the SPEs would be unable to meet their obligations and the "hedges" would fail. This is precisely what happened in late 2000 and early 2001. Two of the Raptor SPEs lacked sufficient credit capacity to pay Enron on the "hedges." As a result, in late March 2001, it appeared that Enron would be required to take a pre-tax charge against earnings of more than $500 million to reflect the

shortfall in credit capacity. Rather than take that loss, Enron "restructured" the Raptor vehicles by, among other things, transferring more than $800 million of contracts to receive its own stock to them just before quarter-end. This transaction apparently was not disclosed to or authorized by the Board, involved a transfer of very substantial value for insufficient consideration, and appears inconsistent with governing accounting rules. It continued the concealment of the substantial losses in Enron's merchant investments.

However, even these efforts could not avoid the inevitable results of hedges that were supported only by Enron stock in a declining market. As the value of Enron's merchant investments continued to fall in 2001, the credit problems in the Raptor entities became insoluble. Ultimately, the SPEs were terminated in September 2001. This resulted in the unexpected announcement on October 16, 2001, of a $544 million after-tax charge against earnings. In addition, Enron was required to reduce shareholders' equity by $1.2 billion. While the equity reduction was primarily the result of accounting errors made in 2000 and early 2001, the charge against earnings was the result of Enron's "hedging" its investments—not with a creditworthy counter-party, but with itself.

Consolidation Issues. In addition to the accounting abuses involving use of Enron stock to avoid recognizing losses on merchant investments, the Rhythms transaction involved the same SPE equity problem that undermined Chewco and JEDI. As we stated above, in 2001, Enron and Andersen concluded that Chewco lacked sufficient outside equity at risk to qualify for non-consolidation. At the same time, Enron and Andersen also concluded that the LJM1 SPE in the Rhythms transaction failed the same threshold accounting requirement. In recent Congressional testimony, Andersen's CEO explained that the firm had simply been wrong in 1999 when it concluded (and

presumably advised Enron) that the LJM1 SPE satisfied the non-consolidation requirements. As a result, in November 2001, Enron announced that it would restate prior period financials to consolidate the LJM1 SPE retroactively to 1999. This retroactive consolidation decreased Enron's reported net income by $95 million (of $893 million total) in 1999 and by $8 million (of $979 million total) in 2000.

Self-Dealing Issues. While these related-party transactions facilitated a variety of accounting and financial reporting abuses by Enron, they were extraordinarily lucrative for Fastow and others. In exchange for their passive and largely risk-free roles in these transactions, the LJM partnerships and their investors were richly rewarded. Fastow and other Enron employees received tens of millions of dollars they should not have received. These benefits came at Enron's expense.

When Enron and LJM1 (through Fastow) negotiated a termination of the Rhythms "hedge" in 2000, the terms of the transaction were extraordinarily generous to LJM1 and its investors. These investors walked away with tens of millions of dollars in value that, in an arm's-length context, Enron would never have given away. Moreover, based on the information available to us, it appears that Fastow had offered interests in the Rhythms termination to Kopper and four other Enron employees. These investments, in a partnership called "Southampton Place," provided spectacular returns. In exchange for a $25,000 investment, Fastow received (through a family foundation) *$4.5 million* in approximately two months. Two other employees, who each invested $5,800, each received *$1 million* in the same time period. We have seen no evidence that Fastow or any of these employees obtained clearance for those investments, as required by Enron's Code of Conduct. Kopper and the other Enron employees who received these vast

returns were all involved in transactions between Enron and the LJM partnerships in 2000—some representing Enron.

Public Disclosure

Enron's publicly-filed reports disclosed the existence of the LJM partnerships. Indeed, there was substantial factual information about Enron's transactions with these partnerships in Enron's quarterly and annual reports and in its proxy statements. Various disclosures were approved by one or more of Enron's outside auditors and its inside and outside counsel. However, these disclosures were obtuse, did not communicate the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships. The disclosures also did not communicate the nature or extent of Fastow's financial interest in the LJM partnerships. This was the result of an effort to avoid disclosing Fastow's financial interest and to downplay the significance of the related-party transactions and, in some respects, to disguise their substance and import. The disclosures also asserted that the related-party transactions were reasonable compared to transactions with third parties, apparently without any factual basis. The process by which the relevant disclosures were crafted was influenced substantially by Enron Global Finance (Fastow's group). There was an absence of forceful and effective oversight by Senior Enron Management and in-house counsel, and objective and critical professional advice by outside counsel at Vinson & Elkins, or auditors at Andersen.

The Participants

The actions and inactions of many participants led to the related-party abuses, and the financial reporting and disclosure failures, that we identify in our Report. These participants include not only the employees who enriched themselves at Enron's expense, but also Enron's Management, Board of Directors and outside advisors. The factual basis and analysis for these conclusions are set out in the Report. In summary, based on the evidence available to us, the Committee notes the following:

Andrew Fastow. Fastow was Enron's Chief Financial Officer and was involved on both sides of the related-party transactions. What he presented as an arrangement intended to benefit Enron became, over time, a means of both enriching himself personally and facilitating manipulation of Enron's financial statements. Both of these objectives were inconsistent with Fastow's fiduciary duties to Enron and anything the Board authorized. The evidence suggests that he (1) placed his own personal interests and those of the LJM partnerships ahead of Enron's interests; (2) used his position in Enron to influence (or attempt to influence) Enron employees who were engaging in transactions on Enron's behalf with the LJM partnerships; and (3) failed to disclose to Enron's Board of Directors important information it was entitled to receive. In particular, we have seen no evidence that he disclosed Kopper's role in Chewco or LJM2, or the level of profitability of the LJM partnerships (and his personal and family interests in those profits), which far exceeded what he had led the Board to expect. He apparently also violated and caused violations of Enron's Code of Conduct by purchasing, and offering to Enron employees, extraordinarily lucrative interests in the Southampton Place

partnership. He did so at a time when at least one of those employees was actively working on Enron's behalf in transactions with LJM2.

Enron's Management. Individually, and collectively, Enron's Management failed to carry out its substantive responsibility for ensuring that the transactions were fair to Enron—which in many cases they were not—and its responsibility for implementing a system of oversight and controls over the transactions with the LJM partnerships. There were several direct consequences of this failure: transactions were executed on terms that were not fair to Enron and that enriched Fastow and others; Enron engaged in transactions that had little economic substance and misstated Enron's financial results; and the disclosures Enron made to its shareholders and the public did not fully or accurately communicate relevant information. We discuss here the involvement of Kenneth Lay, Jeffrey Skilling, Richard Causey, and Richard Buy.

For much of the period in question, Lay was the Chief Executive Officer of Enron and, in effect, the captain of the ship. As CEO, he had the ultimate responsibility for taking reasonable steps to ensure that the officers reporting to him performed their oversight duties properly. He does not appear to have directed their attention, or his own, to the oversight of the LJM partnerships. Ultimately, a large measure of the responsibility rests with the CEO.

Lay approved the arrangements under which Enron permitted Fastow to engage in related-party transactions with Enron and authorized the Rhythms transaction and three of the Raptor vehicles. He bears significant responsibility for those flawed decisions, as well as for Enron's failure to implement sufficiently rigorous procedural controls to

prevent the abuses that flowed from this inherent conflict of interest. In connection with the LJM transactions, the evidence we have examined suggests that Lay functioned almost entirely as a Director, and less as a member of Management. It appears that both he and Skilling agreed, and the Board understood, that Skilling was the senior member of Management responsible for the LJM relationship.

Skilling was Enron's President and Chief Operating Officer, and later its Chief Executive Officer, until his resignation in August 2001. The Board assumed, and properly so, that during the entire period of time covered by the events discussed in this Report, Skilling was sufficiently knowledgeable of and involved in the overall operations of Enron that he would see to it that matters of significance would be brought to the Board's attention. With respect to the LJM partnerships, Skilling personally supported the Board's decision to permit Fastow to proceed with LJM, notwithstanding Fastow's conflict of interest. Skilling had direct responsibility for ensuring that those reporting to him performed their oversight duties properly. He likewise had substantial responsibility to make sure that the internal controls that the Board put in place—particularly those involving related-party transactions with the Company's CFO—functioned properly. He has described the detail of his expressly-assigned oversight role as minimal. That answer, however, misses the point. As the magnitude and significance of the related-party transactions to Enron increased over time, it is difficult to understand why Skilling did not ensure that those controls were rigorously adhered to and enforced. Based upon his own description of events, Skilling does not appear to have given much attention to these duties. Skilling certainly knew or should have known of the magnitude and the risks associated with these transactions. Skilling, who prides himself on the controls he

put in place in many areas at Enron, bears substantial responsibility for the failure of the system of internal controls to mitigate the risk inherent in the relationship between Enron and the LJM partnerships.

Skilling met in March 2000 with Jeffrey McMahon, Enron's Treasurer (who reported to Fastow). McMahon told us that he approached Skilling with serious concerns about Enron's dealings with the LJM partnerships. McMahon and Skilling disagree on some important elements of what was said. However, if McMahon's account (which is reflected in what he describes as contemporaneous talking points for the discussion) is correct, it appears that Skilling did not take action (nor did McMahon approach Lay or the Board) after being put on notice that Fastow was pressuring Enron employees who were negotiating with LJM—clear evidence that the controls were not effective. There also is conflicting evidence regarding Skilling's knowledge of the March 2001 Raptor restructuring transaction. Although Skilling denies it, if the account of other Enron employees is accurate, Skilling both approved a transaction that was designed to conceal substantial losses in Enron's merchant investments and withheld from the Board important information about that transaction.

Causey was and is Enron's Chief Accounting Officer. He presided over and participated in a series of accounting judgments that, based on the accounting advice we have received, went well beyond the aggressive. The fact that these judgments were, in most if not all cases, made with the concurrence of Andersen is a significant, though not entirely exonerating, fact.

Causey was also charged by the Board of Directors with a substantial role in the oversight of Enron's relationship with the LJM partnerships. He was to review and approve all transactions between Enron and the LJM partnerships, and he was to review those transactions with the Audit and Compliance Committee annually. The evidence we have examined suggests that he did not implement a procedure for identifying all LJM1 or LJM2 transactions and did not give those transactions the level of scrutiny the Board had reason to believe he would. He did not provide the Audit and Compliance Committee with the full and complete information about the transactions, in particular the Raptor III and Raptor restructuring transactions, that it needed to fulfill its duties.

Buy was and is Enron's Senior Risk Officer. The Board of Directors also charged him with a substantial role in the oversight of Enron's relationship with the LJM partnerships. He was to review and approve all transactions between them. The evidence we have examined suggests that he did not implement a procedure for identifying all LJM1 or LJM2 transactions. Perhaps more importantly, he apparently saw his role as more narrow than the Board had reason to believe, and did not act affirmatively to carry out (or ensure that others carried out) a careful review of the economic terms of all transactions between Enron and LJM.

The Board of Directors. With respect to the issues that are the subject of this investigation, the Board of Directors failed, in our judgment, in its oversight duties. This had serious consequences for Enron, its employees, and its shareholders.

The Board of Directors approved the arrangements that allowed the Company's CFO to serve as general partner in partnerships that participated in significant financial